Three Wolves at the Door

By Tadao Morimoto

President Boris Yeltsin and his leadership team face the need to make three crucial policy decisions now that Russia has been plunged into inescapable and overriding crises in this historic time of transition following the collapse of the union. The first is to change the principles governing Russian foreign policy, second is to work out a domestic policy compromise with the middle-roaders that will prolong his administration's effective life, and third is to move away from the IMF macroeconomic dictates on economic reform. While they may appear separate and discrete policy decisions, these represent three concentric realms all stemming from the failure of the economic reform policies to date.

Foreign policy

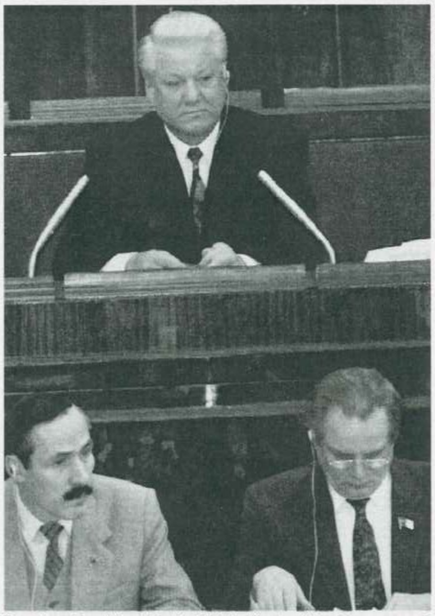
Foreign policy is the first issue. On October 6, 1992, President Yeltsin addressed the opening of the Supreme Soviet of the Russian Federation and stressed that he intended to move to a foreign policy that put Russian interests first. Following that and based on an October 28 Yeltsin speech at the Foreign Ministry, the ministry released a draft of "The Concept of Russian Foreign Policy" on November 3 outlining in considerable detail exactly how Russia intended to use foreign policy in pursuit of its national interests. The important point to be remembered in looking at the Concept of Russian Foreign Policy is that it stemmed from a feeling among the conservatives and military people that former Soviet President Mikhail Gorbachev's "new thinking" had represented a series of concessions to the West.

As stated in the concept, it is imperative that Russian foreign policy be in the national interest, and the first point was that Russia should develop better relations with those countries (especially economically strong countries and NIEs) that contribute to the success of Russia's own economic reforms. The reason Russia felt it had to turn its attention increasingly to the NIEs is that the global recession in the industrial countries and elsewhere has led to a noticeable contraction in economic assistance for Russia, thus pushing Russia to turn to the NIEs of East Asia and to such South Asian countries as Turkey, Iran and Pakistan for their high growth rates.

In hindsight, it is apparent that the cancellation of Yeltsin's scheduled visit to Japan on September 9 was the first concrete manifestation of this new foreign policy orientation. If the government of Japan is going to adopt a hard line on the inseparability of economics and politics and insist that it cannot release any major economic support per se so long as a territorial dispute over islands seized by the Soviets at the end of World War II and referred to in Japan as the Northern Territories remains unresolved, the logic goes, then freezing Japan-Russia relations for the time being is not going to do any harm to Russian national interests in the medium term. Hence the cancellation of the visit. While such policy thinking and the resultant cancellation display a Great Power arrogance that assumes it can do whatever it wants and flout the norms of accepted diplomatic civility, the bluff was in fact motivated by the very serious economic crisis that Russia faces.

In striking contrast, Yeltsin paid a three-day visit to South Korea starting on November 18, 1992, and the two countries concluded a Basic Agreement. Economically, this Basic Agreement was advanced by the fact that the two sides had finally reached agreement in principle on the resumption of an economic support package for Russia worth approximately $1.5 billion.

At the same time, this visit to South Korea saw Russia promise to amend or abrogate its Agreement on Friendly Cooperation and Mutual Assistance with the Democratic People's Republic of Korea (North Korea), this pledge doubtless made because of a decision that North Korea is an economic burden Russia can ill afford, that North Korea is an outcast in the international community, and that it would be in Russia's national interests to cut North Korea loose. The visit to South Korea was clearly the second concrete manifestation of this new foreign policy orientation.



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Russian President Boris Yeltsin (top) at the Congress of People's Deputies last December in which he was forced to drop reformist acting Prime Minister Yegor Gaidar in favor of conservative industrialist Viktor Chernomyrdin.

However, the concept contains considerable portions of contradiction and confusion. Looking just at the section on relations with Japan, for example, it says (i) that relations with Japan are important and the failure to sign a peace treaty with Japan is a relic of the Cold War, and (ii) that Japan plays an important role within the G-7 industrial countries and it is important to deal with Japan within the global context, but (iii) that there is a need to reach a shared recognition that Japan-Russia bilateral relations overall can be further developed even in the absence of a peace treaty. In addition, it states (iv) that Russia needs to agree with Japan on abandoning the principle of the inseparability of politics and economics, and (v) that there will probably be no real progress in Japan-Russia relations until after the territorial issue is resolved.

This text not only rejects Japan's longstanding policy toward relations with Russia but also repudiates the principle of "law and justice" enunciated by Russia itself. There is also a great lack of consistency in the concept, and several sections utterly defy comprehension. While the concept reflects the extreme political, ethnic, and economic situation prevailing in Russia, it should be axiomatic that any new political framework in Northeast Asia has to include Japan.

In the section on the United States, the concept says that improving relations with the United States is Russian foreign policy's highest priority but contends that the U.S. is seeking to gain unilateral advantage in the arms control process and that the American military-industrial complex is hoping that the Russian defense sector will lose its technological capability as the economy shifts from military industry to civilian industry. This contention is another reflection of the dissatisfaction among conservatives and military people and their feeling that the old Soviet leadership gave away too much to the United States under Gorbachev's "new thinking" and Russian interests and war potential have been compromised as a result.

At the same time, there is also an undercurrent of feeling here that, with foreign-currency earnings off as a result of the sharp decline in oil exports, Russia should play down its go-nowhere economic reform conversion from military to consumer goods and should step up the volume and quality of its military production and make a determined push into the international arms bazaar. This also ties into the statement elsewhere in the concept that arms exports and other exports in areas where Russia is still competitive may engender some friction with the leading Western countries, and this seems to be a clear statement that Russia intends to position itself as a major arms exporter and "merchant of death."

The section on relations with Eastern Europe says that the efforts to keep Eastern Europe from developing into a buffer zone isolating Russia from the West and to block Western efforts to get Russia to withdraw from Eastern Europe are intended to make Eastern Europe, which had been abandoned under the "new thinking," a "reverse buffer zone," and it also calls for a long-term strategy to find ways to revive economic relations with these countries, formerly Russia's most important trading partners and now seriously depressed. However, the countries of Eastern Europe are no longer the old Soviet satellites they once were, and it will most probably be impossible to turn back the clock.

Changing the IMF prescription

The second issue (compromising with the middle-roaders) and the third issue (altering the IMF macroeconomic prescription) overlap. Looking at relations with the IMF, Russia, as is well known, railroaded through "shock therapy" from the monetarist perspective on January 2, 1992, in an effort to achieve the macroeconomic balance the IMF wanted. Yet for this policy to succeed, the Russian economy first had to be prepared for market mechanisms. Otherwise, the shock therapy would only serve to push reform over the brink all the faster.

There were three main pillars to these reforms: price deregulation, fiscal balance, and tight-money policies. Yet the reforms were fraught with contradiction from the very beginning—contradictions caused by grave procedural errors.

If price deregulation was to succeed, for example, the move to a market economy also had to succeed, and this could not succeed without (i) agrarian land reform on the collective farms, (ii) the breakup or dissolution of those state monopolies that control 96.4% of mining and manufacturing output, and (iii) the creation of competitive conditions. No progress has been made on these fronts, however, and the state monopoly enterprises still sit astride the economy.

Given this situation, it continues to be a seller's market and the Marxist dogma that costs equal price still holds. Yet so long as costs are passed along in prices and inflation continues to be rampant, costs will continue to go up and it will be impossible to avoid spiraling hyperinflation. In actual fact, taking December 1991 as the benchmark of 100, the consumer price index was 1,310 and the industrial producer price index 1,710 in September 1992. With these ferocious price rises unabated, it is estimated that the price index was 2,200 by the end of 1992.

However, the breakup and dissolution of the state monopolies has met hard resistance from those entrenched in positions of power in these enterprises and determined to use this base to preserve their privileges, and this clearly cannot be accomplished overnight. Yeltsin has issued "privatization vouchers" to every man, woman and child in Russia in an attempt to privatize the state enterprises by selling shares in them to the public, but simply selling them off without breaking them up only changes the pattern of ownership and does nothing to change their basic monopoly position.

Political authoritarianism may have crumbled in Russia, but monopoly authoritarianism is alive and well.

Fiscal balance

The second issue is that of fiscal balance. Here, policies were announced to cut expenditures by reining in the two largest spending items (price subsidies and military spending) and to enhance the revenue side by making the income tax schedule more progressive and instituting a value-added tax (initially set at 28%), but the combination of higher spending for the agri-industrial complex, for military conversion, and for social security to cope with the hyperinflation meant that the fiscal deficit topped the IMF target line (no more than 5% of GNP) in the third quarter of 1992, rising to 10% of GNP then and probably to 15% of GNP by the end of the year. Moreover, since Russia does not have a tradition of issuing government bonds, it has had to resort to the primitive expediency of printing more money to pay for this deficit.

The more hyperinflation there is, the greater the demand for money and the more money is printed willy-nilly to meet the liquidity shortage. As production fell and prices continued their upward climb, the amount of money printed in the first nine months of 1992 was 15.8 times that in the same period of 1991. Yet not even that was enough, and inter-corporate credit had soared to approximately 3 trillion rubles—30% of GNP—as of July 1, 1992, and nonpayment of wages is endemic throughout the economy. Trying to combat this situation, the central bank issued 1.1 trillion rubles of new money in an effort to help industry get back on its feet, but this new injection only served to worsen the economy's dependency.

The third issue is that of tight-money policies, where the government has drastically cut investment across the board and jacked up the official discount rate. (As of this writing, the official discount rate is 80%, and interest rates on commercial bank lending are 100% to 120%.) The problem arises in that the higher official discount rates have meant indiscriminately slashing investment in both industries (semi-macroeconomic) and in businesses (microeconomic), and this overkill has seriously weakened the economy as a whole.

Investment in the first quarter of 1992 was 44% less than in the same quarter of 1991—a decline without peacetime precedent in Russia—but the longer-term figures are at least just as bad, the first half of the year recording a 46% decline and the first nine months of the year a 48% decline. This free-fall decline in investment has, of course, generated an equally precarious decline in production. Industrial production was 13% less in the first quarter of 1992 than in the same period of 1991, and the equivalent figures for the first half of 1992 are 14.8% and the first nine months 17.6%. Production is in unmitigated decline—a decline that gets worse every month. In July 1992, production was 21.5% less than in July 1991. In August, it was down 27.2% from the previous year. Nor is this restricted to manufacturing. Food production was off 23% in the first half of 1992.

When the economic reforms were started in January 1992, one out of every 16 enterprises was running a deficit. By July 1992, this was one in six. The ruble's value has plummeted. Whereas the target was to stabilize the ruble at 70 rubles to the dollar after July 1, 1992, the actual rate had already plunged headlong to 419 rubles to the dollar by November 10, 1992.

Dead-end policies

It had become increasingly clear with every passing day that the economic reforms promoted by acting Prime Minister Yegor Gaidar were doomed, and the conservatives and middle-roaders around the military-industrial complex which has seen its orders slashed by between 60% and 70% had been calling for changes in the IMF-Gaidar line. In particular, with such middle-of-the-road forces as the Civic Union led by Vice President A. Rutskoi, the chairman of the All-Russia Union of Industrialists and Entrepreneurs A. Volsky, Russian Democrat Party head N. Travkin, and other leaders having joined hands with the labor unions and having developed into a powerful source of pressure on Yeltsin for the abandonment of "shock therapy" and a return to more realistic policies, it was probably only to be expected that the Yeltsin government would try to work out a realistic compromise with the middle to stay in power.

Such a "compromise with reality" will mean a change from the macroeconomic policies outlined by the IMF, and there had been signs of disenchantment with the IMF within the Russian leadership. As seen in Yeltsin's speech to the Supreme Soviet on October 6, 1992, there has even been public recognition of the errors in the IMF's macroeconomic prescription. On November 13, Deputy Prime Minister Mikhail Poltoranin explicitly stated that Russia henceforth intends to pursue its own economic policies rather than follow the IMF's advice.

Having made a mess of reforms implemented in line with the IMF scenario and having rejected undue interference by the West (particularly the G-7 countries) in the IMF Trojan horse, Russia still faces the difficult question of implementing its own bootstrap economic reforms. No specific policies have been forthcoming on this yet, and Russia seems to have gotten itself into a cul de sac with no way out. Russia is thus a, if not *the*, major cause of concern for the international community as we close out the 20th century. The post-Cold War euphoria is over, and we are now in the grips of a new age of chaos.

Photo: WWP

Demonstrators in Moscow's Red Square protesting against President Yeltsin's economic policies as the Congress of People's Deputies opened.

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